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BEFORE THE ARIZONA CORPORATION COMMISSION

AZ CORP COMMISSION

Arizona Corporation Commission

DOCKET CONTROL

COMMISSIONERS

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BOB STUMP, Chairman
GARY PIERCE
BRENDA BURNS
BOB BURNS
SUSAN BITTER SMITH

DOCKETED BY

In the matter of

DOCKET NO. S-20757A-10-0373

Richard M. Scherman, (CRD# 1302988)
individually and d/b/a Diversified Financial
and/or Diversified Financial Planners, and
Amy Scherman, husband and wife;

SECURITIES DIVISION'S POST HEARING
BRIEF

Hearing Dates: September 30 through October 2,
2013

Respondents.

Assigned to Administrative Law
Judge Marc E. Stern

The Securities Division ("Division") of the Arizona Corporation Commission
("Commission") submits its post-hearing brief as follows:

A. JURISDICTION.

The Commission has jurisdiction over this matter pursuant to Article XV of the Arizona
Constitution, the Securities Act of Arizona, A.R.S. § 44-1801 *et seq.* ("Securities Act"), and the
Investment Management Act of Arizona, A.R.S. . § 44-3101 *et seq.* ("IM Act").

On September 9, 2010, the Division filed a Notice of Opportunity for hearing regarding a
proposed order to cease and desist, order of revocation, order of denial, and order for other affirmative
action ("Notice") against Richard M. Scherman ("Scherman" or "Respondent") within two years
of termination or lapse of his registration as a securities salesman and licensure as an investment
adviser representative ("IAR"). A.R.S. §§ 44-1963(D) and 44-3202(D), requires that an action to
revoke, suspend, or deny must *begin* within two years of the termination or lapse. Here, the Division
began its action against Scherman by filing a Notice within two years of his termination, in March
2010 by United Planners' Financial Services of America, a limited partnership ("United Planners"),

1 where he was registered as a securities salesman and a licensed IAR and within two years of his IAR
2 licensing application filed May 28, 2010.

3 **B. FACTS.**

4 From at least September 1995, Schmerman, an Arizona resident, has misrepresented his
5 qualification to investment clients that he was a licensed investment advisor. (S-20a). In numerous
6 instances, Schmerman provided company letters to investment clients that stated he was a "Registered
7 Investment Advisor" or "Licensed Investment Advisor." (See S-20a, S-20b, S-20c; S-31; Hr'g Tr.
8 Vol.I, p.33-35; S-61). Schmerman has never been a licensed investment adviser ("IA") with the State
9 of Arizona and has not been a federally licensed IA since February 10, 1995. (S-1a). Schmerman
10 conducted business under the trade names of Diversified Financial and Diversified Financial Planners
11 (collectively "DF"). (S-2). DF has never been a licensed IA with the State of Arizona or federally. (S-
12 1b).

13 Schmerman was a registered securities salesman from November 4, 1986, to March 13, 2008,
14 and from May 15, 2008, to March 10, 2010, CRD# 1302988,¹ in association with various registered
15 dealers or investment firms.² On March 10, 2010, Schmerman's association with a broker dealer was
16 terminated. (S-72b). From June 3, 2008, to March 10, 2010, Schmerman was licensed in Arizona as
17 an IAR in association with United Planners.

18 Schmerman stated in writing to clients that he would provide the following investment
19 services: (1) develop investment planning strategies for the individual situation; (2) identify the
20 client's financial goals and objectives and organize their financial portfolio in light of their goals and
21 objectives; (3) review and manage their new investment portfolio; and (4) assess an investment
22

23 ¹ On November 4, 1986, Schmerman became a registered securities salesman with FINRA and on November 6, 1986,
24 Schmerman became a registered securities salesman with the state of Arizona.

25 ² From March 1999 to March 2008, Schmerman was registered in Arizona as a securities salesman in association with
26 Mutual Service Corporation ("MSC"). During the same time frame, MSC, CRD# 4806, was a federally licensed IA
and an IA notice filer in Arizona. MSC is also a registered securities dealer, federally and with the state of Arizona.
Respondent received fees through MSC and prior to March 31, 1999 through its predecessor, Titan Value Equities
Group. From May 15, 2008, to March 10, 2010, Schmerman was registered as a securities salesman in Arizona in
association with United Planners. United Planners, CRD# 20804, is a federally licensed IA and an IA notice filer in
Arizona. United Planners is also a registered securities dealer, federally and with the state of Arizona.

1 advisory fee of one percent (1%) to one-point five percent (1.5%). (S-7, ACC000026; S-20a & S-20b;
2 S-23b, ACC009713).

3 For many clients, Schmerman engaged Charles Schwab & Co, Inc., ("Schwab") for brokerage
4 services. Clients would open a Schwab brokerage account, would name DF as the IA firm for the
5 account, provide Schmerman with trading authorization, and fee withdrawal authorization. (See S-24b
6 Elizabeth Aiken application dated 6/3/08; S-29b – Patricia Beauvais application dated 12/17/97; S-29c
7 – C and P Beauvais Trust application dated 12/17/97).

8 During the administrative hearing, Greg Thomsen, a special investigator, testified regarding his
9 participation in the investigation and was accepted as an expert in technology and audio files. Sean
10 Callahan, a forensic accountant, testified and was accepted as an expert in accounting. Mr. Callahan
11 stated that he reviewed approximately eight to ten accounts for Schmerman but narrowed it down to
12 four main accounts where the bulk of the transactions occurred. (Hr'g Tr. Vol.II, p.317). Mr.
13 Callahan's analyses and reports cover the timeframe of January 2005 through April 2011. Mr.
14 Callahan analyzed the flow of client funds and how those client funds were disbursed.

15 The Division also called Elizabeth Aiken ("Mrs. Aiken"), Judy Pellish (Mrs. Pellish"), Buritt
16 Steward ("Mr. Steward"), and Rolf Vrla ("Dr. Vrla"), who were Schmerman investment clients.

17 Mr. Steward testified that Schmerman had been handling his investments for over twenty
18 years. (Hr'g Tr. Vol.I, p.32). Schmerman charged an investment advisory fee of approximately 1.5%.
19 (Hr'g Tr. Vol.I, p.52). Mr. Steward received multiple correspondences from Schmerman that
20 misrepresented Schmerman was a registered or licensed investment advisor. (S-20a & S-20b).
21 Believing that Schmerman was actually registered or licensed as an investment advisor gave Mr.
22 Steward a level of comfort and trust because to him it meant Schmerman was "qualified and [that] he's
23 licensed." (Hr'g Tr. Vol.I, p.36, ln.8). Mr. Steward also expected that Schmerman had his best
24 financial interest at heart. (Hr'g Tr. Vol.I, p.36). Beginning in 2005, Mr. Steward implemented a
25 financial estate plan to avoid inconveniencing his children with taxes on their inheritance once he died
26 and engaged Schmerman to assist him. Mr. Steward liquidated certain stock holdings and gave

1 Schmerman three checks, \$162,620 dated July 22, 2005, \$86,897 dated May 3, 2006, and \$100,000
2 dated May 20, 2010, and in each instance Schmerman was to reinvest those funds into other securities
3 or hold them for Mr. Steward's children. (Hr'g Tr. Vol.I, pp.35-47). Instead, Schmerman used the
4 \$162,620 to pay an unrelated civil settlement where he was civilly liable for a settlement of \$790,000
5 to the Ruth Gunston Estate. Mr. Callahan further detailed that the bulk of Mr. Steward's remaining
6 funds went for other improper purposes, such as payments to other Schmerman clients that Mr.
7 Steward has no relation to, cash withdrawals, or deposits into Schmerman's personal bank account.
8 (S-71b). Mr. Steward felt that Schmerman was dishonest with him in how his money was invested
9 and used. (Hr'g Tr. Vol.I, p.47).

10 Mrs. Aiken was another investment client of Schmerman. In 2005, Mrs. Aiken and her mother
11 (Gloria Aiken) went to Schmerman to manage and invest \$175,000 of Gloria Aiken's money and Mrs.
12 Aiken was present for all those meetings. (Hr'g Tr. Vol.II, p.217). Schmerman told them the money
13 would be invested in a money market account in Gloria Aiken's name or for her direct benefit.
14 Schmerman was paid a fee for managing the money. (Id). On May 4, 2005, Schmerman deposited
15 Gloria Aiken's \$175,000 into Schmerman's Wells Fargo bank account # 0016, rather than a money
16 market account in her name. Schmerman never purchased a CD, money market instrument, or any
17 type of direct investment in Gloria Aiken's name. (S-59e). Schmerman made periodic payments to
18 Gloria Aiken under the guise of interest or profits. (S-7, ACC000042). Schmerman also
19 misrepresented that he was a "Licensed Investment Advisor" in written communications. (S-7).

20 Around August 2008, Gloria Aiken gifted the remaining \$117,204 balance of the account to
21 Mrs. Aiken. Mrs. Aiken became a Schmerman client and signed a Schwab brokerage account
22 application. Schmerman managed the money, provided investment advice, and charged a fee for his
23 investment services. (Hr'g Tr. Vol.II, p.206; S-7, ACC000026). Schmerman misrepresented to Mrs.
24 Aiken that he had opened a Schwab brokerage account in her name and had setup a Schwab account
25 for the entire gifted amount of \$117,204. (S-7, ACC000016 & 41). For years, Mrs. Aiken believed
26 that the money was in the Schwab account and requested periodic distributions from Schmerman. In

1 reality the Schwab account was never funded with any money. (S-24a). It was not until November
2 2009, when Mrs. Aiken experienced trouble getting her money from Schmerman, that she contacted
3 Schwab and discovered the Schwab account was never funded. Mrs. Aiken felt Schmerman was
4 deceptive and dishonest with her about how he handled her financial affairs. (Hr'g Tr. Vol.II, p.217).

5 Mrs. Pellish is Schmerman's aunt. Mrs. Pellish testified that she trusted Schmerman and in
6 1997 she engaged Schmerman for her investments. (Hr'g. Tr. Vol.I, p.62; S-61). Schmerman also
7 misrepresented to Mrs. Pellish that he was a "Registered Investment Advisor" in a March 8, 2004
8 letter. (Ex. S-61). Mrs. Pellish was told by Schmerman that her funds would be invested in bonds and
9 other income producing securities. Mrs. Pellish sought a monthly income stream during her life with
10 the remainder to be passed on to her kids upon her death. Mrs. Pellish opened various brokerage
11 accounts with DF designated as the investment management firm on the applications. (S-61,
12 ACC018016-18026). On June 9, 1997, Mrs. Pellish provided two checks totaling \$300,000 to
13 Schmerman, which was money she had made from selling her home in California before moving to
14 Arizona to retire, and each check contained a memo "Purchase of Bonds." (S-62). In December 2009,
15 Mrs. Pellish gave Schmerman another \$20,000 to invest in bonds after Schmerman told her bonds
16 were doing well in the market. Mrs. Pellish had no proof that \$320,000 worth of bonds were ever
17 purchased in her brokerage account or for her direct benefit. Because of Schmerman's representation
18 of licensure and because he was family, Mrs. Pellish trusted him with all her heart. (Hr'g. Tr. Vol.I,
19 p.66). Over the years, when Mrs. Pellish asked about her investments, Schmerman would tell her the
20 "money was safe" or "I'll take care of you" (Hr'g Tr. Vol.I, p.67). When Mrs. Pellish confronted
21 Schmerman about the status of her \$20,000 December 2009 bond purchase, Schmerman failed to
22 disclose he had already spent the money and said the bond market was bad and that he would just hold
23 the money until the time was right again to purchase the bonds. Mr. Callahan testified that a \$20,000
24 payment dated December 17, 2009, from Mrs. Pellish and made payable to Schmerman included a
25 memo for "bonds." Mr. Callahan detailed that the \$20,000 was deposited into Schmerman's Wells
26 Fargo account and immediately thereafter Schmerman disbursed two checks totaling \$13,800 to other

1 investors and withdrew \$6,200 as cash. (S-70a). Mrs. Pellish testified that she felt Schmerman was
2 dishonest with her in how he handled her financial affairs. (Hr'g Tr. Vol.I, p.96). Mrs. Pellish has
3 approximately \$115,000 still outstanding.

4 Dr. Vrla was a Schmerman investment client since 2000. (S-64). Schmerman handled various
5 investment accounts for Dr. Vrla, his pension, and family members through Schwab for a fee of one
6 percent (1%). (Id). Schmerman also misrepresented to Dr. Vrla on correspondences that he was a
7 registered investment advisor. (Id). As long as Dr. Vrla could recall, Schmerman always deducted his
8 advisory fees directly from the Schwab account. In late 2010 or early 2011, Schmerman submitted
9 invoices that requested quarterly advisory fees for 2010. (S-64). Schmerman never disclosed to Dr.
10 Vrla that he was no longer associated with a broker dealer or that he was removed from accessing
11 client accounts through Schwab on April 5, 2010. (S-22d). Instead, Schmerman told Dr. Vrla that a
12 new procedure was required wherein Schwab would submit a check to Dr. Vrla (instead of paying
13 Schmerman directly) and Dr. Vrla would re-submit a personal check to Schmerman for the advisory
14 fees. Dr. Vrla testified that he paid Schmerman for advisory services as late as August 2011. (S-64). It
15 was not until November 2011 that Dr. Vrla became aware that Schmerman had been terminated as a
16 registered representative in March 2010 and had no ability to access Dr. Vrla's various Schwab
17 accounts since April 2010. (Hr'g Tr. Vol.I, p.111). In total, Dr. Vrla paid Schmerman over \$35,000
18 for IA fees after March 10, 2010, for investment advisory services Schmerman never rendered.

19 Numerous other clients paid unearned investment advisory fees to Schmerman because they
20 were misled. Schmerman submitted invoices to Ann Dragnich, the Levine limited partnership, and
21 Dick Witter for alleged investment advisory services that he could not and did not perform because
22 they each covered a period of time *after* he was terminated as a securities salesman and his access to
23 each client's Schwab account had been terminated. (S-32, S-33b, S-34).

24 The evidence also revealed that Schmerman diverted client funds and assets for his own
25 personal benefit. For example, Patricia Beauvais was an investment client since 1997 and she passed
26 away on July 22, 2007. (S-26b & S-29b). On July 5, 2005, by a second amendment to the C and P

1 Beauvais Trust, Schmerman was named a successor trustee if Mrs. Beauvais was unable to perform
2 the trustee duties. Schmerman became the trustee for Mrs. Beauvais' C and P Beauvais Trust upon
3 Mrs. Beauvais' death. Mrs. Beauvais memorialized how she wanted her assets distributed by the
4 trustee upon her death, as laid out in her trust documentation. Mr. Schmerman is not named as a
5 beneficiary on any trust document or schedule signed by Mrs. Beauvais. Yet, on July 31, 2007, shortly
6 after Mrs. Beauvais died, Schmerman named himself joint signatory on her personal SunWest Federal
7 Credit Union ("SunWest") bank account. (S-27a). Then on May 19, 2009, Schmerman named himself
8 beneficiary of her trust account, provided that revised beneficiary form to Security Title Agency, and
9 sold the personal residence for a net gain of \$368,000. (S-26c; S-28a; S-59c). Schmerman also used
10 the SunWest bank account for personal transfers and withdraws. Instead of disbursing the financial
11 assets of the trust according to Mrs. Beauvais's wishes, Schmerman took the trust assets for his own
12 financial gain. Mr. Callahan described how he reviewed the title documents from Mrs. Beauvais' May
13 20, 2009, home sale, confirmed the net amount of \$368,645 was deposited into the SunWest account,
14 and the funds were withdrawn by Schmerman. (S-59c).

15 Mr. Callahan also testified about exhibits S-54 and S-55, which are summaries of receipts and
16 disbursements for the periods of January 2005 to April 2011, for Schmerman's personal bank accounts
17 and DF's bank account that received client funds. Mr. Callahan's reports detailed that over \$3.2
18 million was received from investors in Schmerman's Wells Fargo account # 0016 and another
19 \$894,875 from client trust accounts, both of which accounted for nearly 82% of all deposits into that
20 account. Yet only one percent (1%) of the total deposits in that account went to investing activities.
21 The bulk of the money was withdrawn as cash by Schmerman totaling \$2,041,138, disbursed or
22 transferred to Schmerman totaling \$1,220,890, and \$695,424 was repaid to investors. (S-54; Hr'g Tr.
23 Vol.II, p.332-338). Mr. Callahan further testified that clients' funds were also used by Schmerman for
24 personal expenses. (Hr'g Tr. Vol.II, p.341; S-54). Mr. Callahan also detailed additional instances
25 where Schmerman failed to invest client funds, used client funds to pay other investors, and/or used
26 client funds for personal expenses (S-59a, S-59b, S-59d, S-59e, and S-59f). Mr. Callahan created a

1 restitution list showing \$3,009,173.32 as an outstanding balance for Schmerman clients based on his
2 accounting analysis. (S-58b).

3 During Mr. Thomsen's participation in the Schmerman investigation, he conducted and/or
4 reviewed documents, interviews, and information. Some of the relevant testimony he provided at the
5 hearing were as follows:

- 6 • Sandra Robinson engaged Schmerman to invest the \$373,390 life insurance proceeds
7 she received from her husband's death. The money was to be placed in a money
8 market-type of investment and not anything with risk, including stocks. Schmerman
9 assured her it would be placed into an institutional account [like Schwab]; however,
10 Mrs. Robinson never received any statements from Schwab or United Planners and
11 now believes her funds were stolen. (Hr'g Tr. Vol.II, p.255-256; S-30, ACC14312).
- 12 • In June 2006, Bernice Elson engaged Schmerman to manage \$125,000 and
13 Schmerman represented that the amount would be placed with Schwab. Schmerman
14 would charge a 1% fee for his advisory services. When Mrs. Elson contacted Schwab
15 personally to seek information about her account, she stated Schwab had no record of
16 any account in her name. (Hr'g Tr. Vol.II, p.260-262).
- 17 • Schmerman executed a promissory note with his investment client Michael Durand for
18 \$375,000 in January 2005. (S-37b).
- 19 • Schmerman borrowed money from his investment client Richard Rubin in February
20 2005 for \$128,000 and October 2006 for \$100,000. (Hr'g Tr. Vol.II, p.293-294).
- 21 • United Planners discharged Schmerman because the firm determined after an
22 investigation that Schmerman had commingled client assets with his checking account.
23 (Hr'g Tr. Vol.II, p.229).

24 Mr. Thomsen also discussed his technological background and expertise and was admitted as an
25 expert. (Hr'g Tr. Vol.I, p.150-154). Mr. Thomsen stated that certain Schmerman clients, like Dr. Vrla
26 and Ann Dragnich, complained that they believed Schmerman was improperly accessing their

1 brokerage accounts after he was delinked by Schwab and terminated by United Planners. (Hr'g Tr.
2 Vol.I, pp.131-133). Mr. Thomsen also spoke to Dr. Vrla personally and interviewed him. Mr.
3 Thomsen testified that during the investigation, he reviewed audio files received from Schwab that
4 consisted of a series of phone calls recorded by Schwab of Schmerman and various Schmerman
5 clients. In one set of audio files, Schmerman called Schwab regarding his personal brokerage
6 accounts. Mr. Thomsen also reviewed audio recordings of Schwab calls related to Dr. Vrla. Mr.
7 Thomsen compared the audio recordings of Schmerman and numerous audio recordings of individuals
8 calling Schwab to access Dr. Vrla's brokerage accounts and he memorialized his findings. (S-67). In
9 at least five instances, Mr. Thomsen discovered audio recordings where the caller's voice was not
10 consistent with Dr. Vrla's voice. (Id). It was his professional opinion the voice impersonating to be Dr.
11 Vrla in order to request money from the Schwab accounts was consistent with Schmerman's voice.
12 (Hr'g Tr. Vol.II, p.303-310). During the hearing, the Schwab audio recordings were played where the
13 caller purports to be Dr. Vrla and Dr. Vrla testified that it was not him on certain recorded phone calls.
14 (Hr. Tr. Vol., pp.135-142). Dr. Vrla, who had spoken to Schmerman on multiple occasions during
15 their investment advisory relationship, identified the voice on multiple audio files as Schmerman's
16 voice. (Id). Dr. Vrla also noted that Schmerman mispronounced his last name numerous times and
17 stated other incorrect identifying information.

18 Schmerman is also subject to a regulatory action. FINRA is a self-regulatory organization
19 ("SRO") that regulates registered securities dealers. On August 15, 2011, in FINRA case number
20 2010022046001, Schmerman executed a letter of acceptance, waiver, and consent ("FINRA
21 Consent"). The FINRA Consent contained the following:

22 a) Schmerman failed to provide requested information and documents in violation of
23 FINRA Rule 8210 and 2010;

24 b) Schmerman violated Rule 2110 and IM-1000-1 when he failed to disclose a 2007
25 federal tax lien on the form U-4 completed on May 13, 2008; and
26

1 c) Schmerman consented to the sanction of being barred from association with any
2 FINRA member in any capacity for an indefinite time, which became effective on the same day. (S-
3 60).

4 At all relevant times, Amy Schmerman has been the spouse of Respondent Schmerman and
5 may be referred to as "Respondent Spouse." Respondent Spouse is joined in this action under A.R.S.
6 § 44-2031(C) and A.R.S. § 44-3291(C) solely for purposes of determining the liability of the marital
7 community.

8 Administrative Law Judge Marc E. Stern ("ALJ") admitted into evidence the Division's
9 exhibits S-1 through S-72, with the exception of S-66b, S-68, and S-69b.

10 **C. LEGAL ARGUMENTS.**

11 **I. THE SECURITIES ACT AND IM ACT PROHIBIT DISHONEST AND
12 UNETHICAL PRACTICES AND FRAUDULENT CONDUCT.**

13 The Securities Act and IM Act prohibit securities salesmen and IARs from engaging in
14 dishonest and unethical conduct if they want to maintain their licenses. *See* A.R.S. §§ 44-1962 and
15 44-3201. Registered securities salesmen and IARs hold trusted positions with their clients and their
16 client's money. Therefore, our statutes and rules prohibit certain acts, practices, or conduct. The
17 Securities Act and IM Act look to the Arizona Administrative Code ("A.A.C.") for a non-exclusive list
18 of acts or conduct that the rule has defined as arising to dishonest and unethical practices.

19 For conduct under the Securities Act, A.A.C. R14-4-130 describes twenty (20) non-exclusive
20 dishonest and unethical practices in the securities industry, within the meaning of A.R.S. § 44-
21 1962(A)(10), whereby any one of them would be grounds to revoke Schmerman's registration as a
22 securities salesman, which was terminated on March 10, 2010. (*See* A.A.C. R14-4-130(A)(1) through
23 (20)).

24 Similarly, for conduct under the IM Act, A.A.C. R14-6-203 describes nineteen (19) non-
25 exclusive dishonest and unethical practices regarding IAs and IARs, within the meaning of A.R.S. §
26 44-3201(A)(13). The dishonest conduct that Schmerman engaged in provides the basis to (a) revoke

his IAR license, which was terminated on March 10, 2010 and (b) deny his IAR application filed May 28, 2010.

Finally, the IM Act prohibits fraudulent conduct. A person violates A.R.S. § 44-3241 when they commit fraud in connection with a transaction within or from Arizona involving the provision of investment advisory services. *See* A.R.S. § 44-3241(A).

II. RESPONDENT ENGAGED IN DISHONEST, UNETHICAL, AND FRAUDULENT CONDUCT AND REVOCATION OF HIS SECURITIES SALESMAN AND INVESTMENT ADVISER REPRESENTATIVE LICENSES IS APPROPRIATE.

1. Revocation of Schmerman's securities salesman license is appropriate due to his dishonest and unethical conduct and his revocation by an SRO.

For the purposes of A.R.S. § 44-1962(10), a dishonest and unethical violation in the securities industry occurs if *any* of the twenty (20) non-exclusive acts or conduct listed in A.A.C. R14-4-130(A) is established. Schmerman violated at least two dishonest and unethical provisions, when he borrowed money from a client and used or converted customer funds for his own personal benefit. *See* A.A.C. R14-4-130(A)(15) and R14-4-130(A)(16). These instances were established during the administrative hearing by the following evidence or testimony:

- A \$375,000 loan from Michael Durand. (S-37b);
- Two loans (\$128,000 and \$100,000) from Richard Rubin to Schmerman. (Hr'g Tr. Vol.II, pp.292-294);
- Using Buritt Steward's \$162,620 to pay a personal legal obligation he incurred from the Ruth Gunston estate. (S-59d);
- Schmerman's ex-employer United Planners disclosed on CRD (occurrence # 1499921) that the firm determined after investigation that Schmerman commingled client assets with his checking account. (See S-72c, p.11); and
- The numerous instances where Schmerman deposited customer funds into his Wells Fargo Bank account and withdrew those funds as cash or transferred it to other personal bank accounts. (S-55 and S-54).

1 Schmerman's clients also felt that his conduct was dishonest and unethical. Clients testified
2 during the hearing that they felt he was dishonest with them in how he spent their money and how he
3 handled their financial affairs.

4 In addition, A.R.S. § 44-1962(A)(12) provides a basis to revoke a salesman's registration if he
5 engages in dishonest and unethical practices in business or financial matters. Though the term "in
6 business or financial matters" is not defined by statute or the A.A.C., Schmerman's conduct in regards
7 to Patricia Beauvais and raiding her trust assets is a dishonest and unethical practice, within the
8 meaning of A.R.S. § 44-1962(A)(12). Mrs. Beauvais was an investment client who passed away on
9 July 22, 2007. Schmerman became the trustee of Mrs. Beauvais's trust and was required to distribute
10 her trust assets as memorialized, upon her death. Yet, after her death, Schmerman named himself joint
11 signatory on her personal SunWest bank account, named himself beneficiary of her trust account, sold
12 the personal residence for a net gain of \$368,000, and used the SunWest bank account for his personal
13 transfers and withdraws. Schmerman took the trust assets for his own financial gain, rather than
14 following Mrs. Beauvais's financial estate plan and trust wishes.

15 Finally, A.R.S. § 44-1962(A)(8) allows the Commission to revoke Schmerman's salesman
16 license based on another agency's action if he is subject to an order of an administrative tribunal, an
17 SRO or the SEC denying, suspending or revoking their membership or registration for at least six
18 months. Here, Schmerman is subject to an order by an SRO, FINRA, wherein they sanctioned his
19 membership or registration. On August 15, 2011, in FINRA case number 2010022046001,
20 Schmerman executed a letter of acceptance, waiver, and consent that included the sanction of being
21 permanently barred from association with any FINRA member in any capacity, which became
22 effective on the same day.

23 Based on Schmerman's conduct, revocation of his securities salesman license is in order
24 and the grounds available for revocation are numerous.

- 1 2. Schmerman's dishonest and unethical conduct is grounds to (a) revoke
2 Schmerman's licensure as an IAR, and (b) deny his May 28, 2010, application as
3 an IAR.

4 From June 3, 2008, to March 10, 2010, Schmerman was licensed in Arizona as an IAR in
5 association with United Planners. From 1996 to the present, Schmerman was not licensed as an IA or
6 IA firm. DF has never been licensed as an IA.³ After being terminated by United Planners,
7 Schmerman organized Diversified Financial Planners, LLC and filed an application to become an IAR
8 for the company.

9 In general, an IA is a legally separate entity or person from an IAR. Usually a corporation or
10 firm is the IA and it employs individuals as IARs. An IAR is any individual who performs functions
11 similar to an officer or director of an IA or is employed by an IA and that person (a) makes
12 recommendations or renders advice regarding securities; (b) manages accounts or portfolios of clients;
13 or (c) solicits, offers, or negotiates for sale, or sells investment advisory services. (See A.R.S. § 44-
14 3101(6)).

15 Schmerman's dishonest and unethical acts also occurred in connection with investment
16 advisory services or advice. Schmerman did business as DF, held DF out as the IA firm, listed DF as
17 the IA firm on client brokerage account applications, submitted invoices and received payment for
18 advisory services, provided recommendations and rendered investment advice to clients regarding
19 what securities to purchase and when, detailed his investment advisory services in writing, and
20 managed various client accounts with discretionary trading through Charles Schwab or by controlling
21 the clients funds in his personal account.

22 A.R.S. § 44-3201 allows the Commission to revoke, deny, or suspend an IAR license if (a) it is
23 in the public interest and (b) the IAR engages in any one of the fourteen (14) acts or practices
24 described in the subsections. See A.R.S. § 44-3201(A)(1) through (14). Both elements are met here.
25

26

³ On May 6, 2010, Schmerman, for and on behalf of Diversified Financial Planners, LLC, filed an application for
 licensure as an IA with the Commission.

1 a. It is in the public interest to revoke and deny Schmerman's IAR license.

2 It is in the public interest to revoke Schmerman's license and deny his application as an IAR
3 because it would protect the public from Schmerman's dishonest and unethical conduct. Schmerman
4 has shown he should not be entrusted with customers' finances or financial affairs. As codified by the
5 statutes and rules, individuals who engage in dishonest and unethical practices should be removed
6 from the securities and investment industry.

7 b. Schmerman violated multiple provisions of A.R.S. § 44-3201.

8 Schmerman violated multiple provisions of A.R.S. § 44-3201 and the Commission can revoke
9 his IAR license and deny his May 28, 2010, IAR application. Some grounds for revocation and denial
10 are as follows:

11 First, similar to the Securities Act, the IM Act also recognizes that a FINRA bar greater than
12 six (6) months is a proper ground to revoke or deny an IAR license. *See* A.R.S. 44-3201(A)(10).
13 Schmerman was barred from association with any FINRA member in any capacity, in FINRA case
14 number 2010022046001.

15 Second, Schmerman engaged in dishonest or unethical practices in the securities industry,
16 within the meaning of A.R.S. § 44-3201(A)(13). A.A.C. R14-6-203 describes nineteen (19) non-
17 exclusive dishonest and unethical practices regarding IAs and IARs, within the meaning of A.R.S. §
18 44-3201(A)(13), whereby any one of them would be grounds to deny, suspend, and revoke
19 Schmerman's licensure as an IAR. Schmerman engaged in dishonest and unethical practices when he
20 borrowed money from unrelated clients (i.e. loans from Michael Durand and Richard Rubin),
21 misrepresented to clients his qualification as a licensed or registered investment advisor, and charged
22 clients unreasonable advisory fees in light of the services provided (i.e. charging Dr. Vrla, Dick Witter,
23 and Ann Dragnich for advisory fees he never provided). (*See* A.A.C. R14-6-203(6), (8), and 10),
24 respectively).

25 Finally, Schmerman engaged in dishonest and unethical practices in business or financial
26 matters, within the meaning of A.R.S. § 44-3201(A)(14), regarding his diversion of assets belonging to

1 the Beauvais trust and the Beauvais estate. Schmerman took his former client's personal and trust
2 assets for his own financial gain.

3 3. Schmerman also committed fraud in violation of A.R.S. § 44-3241.

4 Schmerman's fraudulent conduct is a separate ground to revoke and deny his licensure as an
5 investment adviser representative. A person commits fraud if, in connection with a transaction within
6 or from Arizona involving the provision of investment advisory services, directly or indirectly, does
7 any of the following:

- 8 1. Employ any device, scheme or artifice to defraud.
- 9 2. Make any untrue statement of material fact or omit to state a material fact in light of the
10 statement made so it is not misleading.
- 11 3. Misrepresent any professional qualification with the intent the client rely on the
12 misrepresentation.
- 13 4. Engage in any transaction, practice or course of business that would operate as a fraud
14 or deceit.

15 A.R.S. § 44-3241(A). The fraud provisions of the IM Act apply to "any person" whether they are
16 licensed or unlicensed at the time of the violations. *See* A.R.S. § 44-3241.

17 Schmerman committed multiple frauds while acting as an investment adviser for clients.
18 Some examples are as follows:

19 First, Schmerman misrepresented to multiple clients, like Mrs. Pellish and Gloria Aiken, that
20 their funds would be placed into a money market fund when in fact they were deposited into
21 Schmerman's bank accounts. Schmerman misrepresented to Elizabeth Aiken that her \$117,204 were
22 actually deposited into a Schwab brokerage account but the evidence established that Schmerman
23 never funded the Schwab Account with a single penny. Additionally, Mr. Callahan detailed how
24 Schmerman used client funds to pay other clients. This conduct went on for many years and was a big
25 reason why clients never suspected anything was amiss.
26

1 Second, Schmerman misrepresented his professional qualification to clients on written
2 correspondences that he was a "Registered Investment Advisor" or a "Licensed Investment Advisor,"
3 when, in fact, he was not. During the hearing, multiple witnesses testified how dealing with a person
4 that held himself out as being registered and licensed gave them an additional assurance. For example,
5 Mr. Steward testified that he had a level of comfort and trust because it meant Schmerman was
6 "qualified and [that] he's licensed." Clients trusted that such representations were true and accurate.

7 Finally, Schmerman engaged in fraud and deceit when he misled multiple clients into paying
8 advisory fees when he could not access their accounts after March 2010. Being cut off from access of
9 client accounts did not deter Schmerman as he still came up with a scheme to fool his trusting clients
10 to remit unearned advisory fees by requesting checks be disbursed and then convincing his clients to
11 remit the payment back to him. The ALJ heard testimony from Dr. Vrla who stated it was not his
12 voice calling Schwab to request checks be disbursed from various brokerage accounts and based on his
13 personal knowledge it was Schmerman impersonating him on those numerous phone calls to Schwab.
14 Mr. Thomsen, who analyzed voice recordings, also concluded that it was Schmerman impersonating
15 Dr. Vrla on multiple phone conversations with Charles Schwab in order to request checks on the
16 accounts.

17 **III. SCHMERMAN'S DISHONEST, UNETHICAL, AND FRAUDULENT**
18 **CONDUCT PROVIDES GROUNDS TO ASSESS RESTITUTION AND**
19 **PENALTIES.**

20 The ALJ should order Schmerman to repay restitution of approximately \$3,009,173 and an
21 administrative penalty. When an individual engages in conduct or practices described by A.R.S. §§
22 44-1962(10) or 44-3201(13), the Commission can assess administrative penalties, order restitution,
23 and order the individual to cease and desist. *See* A.R.S. §§ 44-1962(B) and 44-3201(B). Based on
24 Schmerman's dishonest, unethical, and fraudulent conduct, such remedies are appropriate here. As
25 detailed by Mr. Callahan's exhibit S-58b, \$3,009,173 is a net amount outstanding to Schmerman
26 clients. Mr. Callahan used a conservative approach and credited any payments he noted to clients as
 an offset to Schmerman. In addition, Mr. Callahan applied a conservative approach to improper

1 advisory fees because he only included advisory fees paid by clients after March 10, 2010 – even
2 though Mr. Callahan noted that the bulk of client funds were never invested by Schmerman.

3 A large penalty should be assessed in this case due to the scope and length of Schmerman's
4 conduct. The Division recommends a penalty of \$250,000.

5 Schmerman and Amy Schmerman were married and Arizona residents, for all relevant
6 times. Schmerman put forth no evidence to refute or attempt to rebut the community property
7 presumption that Schmerman's debts would be obligations of his and Amy Schmerman's marital
8 community. (*See Hrudka v. Hrudka*, 186 Ariz. 84, 91, 919 P.2d 179, 186 (Ct. App. 1995) "[a]
9 debt incurred by a spouse during marriage is presumed to be a community obligation; a party
10 contesting the community nature of a debt bears the burden of overcoming that presumption by
11 clear and convincing evidence." *See also Arab Monetary Fund v. Hashim*, 219 Ariz. 108, 111,
12 193 P.3d 802, 806 (Ct. App. 2008) "[...] a debt is incurred at the time of the actions that give rise
13 to the debt."). As such, the marital community should be jointly and severally liable for any order
14 of restitution or administrative penalty.

15 **D. CONCLUSION.**

16 Based on the foregoing, the Division respectfully requests the ALJ to recommend an order
17 for restitution in the amount of \$3,009,173, order an administrative penalty in the amount of
18 \$250,000 to address Schmerman's egregious conduct, revoke Schmerman's licenses as a securities
19 salesman and investment adviser representative, deny Schmerman's application for licensure as an
20 investment advisor representative, order any additional relief the Commission deems appropriate,
21 and determine that Schmerman, and the marital community of Schmerman and Amy Schmerman
22 be jointly and severally liable for the full amount of restitution and administrative penalty.

23 Respectfully submitted this 27th day of November, 2013

24
25 By:

26 
Phong (Paul) Huynh
Attorney for the Securities Division of the
Arizona Corporation Commission

1 ORIGINAL AND EIGHT (8) COPIES of the foregoing
2 filed this 27th day of November, 2013 with:

3 Docket Control
4 Arizona Corporation Commission
1200 W. Washington St.
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5 COPY of the foregoing hand-delivered this
6 _27th day of November, 2013 to:

7 Mr. Marc E. Stern
8 Administrative Law Judge
Arizona Corporation Commission/Hearing Division
1200 W. Washington St.
Phoenix, AZ 85007

9
10 COPY of the foregoing mailed this
11 27th day of November, 2013 to:

12 Richard & Amy Schmerman
13 2613 E. Mitchell Dr.
Phoenix, AZ 85016

14
15
16 By: Paul Huynh